
AUDIT REPORT



Suburban Mortgage Associates, Inc., Bethesda, MD, Cost HUD
\$14 Million and Placed an Additional \$26.2 Million at Risk

2005-BO-1008

September 30, 2005

OFFICE OF AUDIT, REGION 1
BOSTON, MA



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TO: Brian Montgomery, Assistant Secretary for Housing – Federal Housing
Commissioner, H
Margarita Maisonette, Director of Departmental Enforcement Center, CV

Michael A. Motulski

FROM: for John A. Dvorak, Regional Inspector General for Audit, 1AGA

SUBJECT: Suburban Mortgage Associates, Incorporated, Bethesda, Maryland, as an
Approved Lender, Cost HUD \$14 Million and Placed an Additional \$26.2
Million at Risk.

HIGHLIGHTS

What We Audited and Why

We audited specific U.S. Department of Housing and Urban Development (HUD) insured mortgages originated and serviced by Suburban Mortgage Associates, Incorporated (Suburban Mortgage), of Bethesda, Maryland. During a review of nursing homes that defaulted on their HUD-insured mortgages, we found that three¹ defaulted nursing homes and one² financially troubled nursing home received HUD-insured mortgages from the same lender, Suburban Mortgage. Our audit objective was to assess the performance of Suburban Mortgage in carrying out its origination and servicing functions through a review of Suburban Mortgage's HUD-insured loans.

¹ Suburban provided these three loans to Coventry Health Center, Edmund Place Health Center, and Hillside Health Center.

² Suburban provided this loan to Mount Saint Francis Health Center.

What We Found

We found significant irregularities in how Suburban Mortgage originated and serviced six HUD-insured loans to affiliated³ entities by failing to perform its fiduciary responsibilities. We identified four HUD-insured loans that Suburban Mortgage originated to identity-of-interest entities. Suburban Mortgage also originated a HUD-insured loan to a property that its executive vice president formerly owned. Additionally, Suburban Mortgage originated a HUD-insured loan to a property whose owners had other business ventures with its executive vice president. Appendix C delineates the relationships between these entities. As of January 24, 2005, three affiliated entities⁴ had defaulted on their loans. Suburban Mortgage requested assignment of the three defaulted loans to HUD. HUD paid Suburban Mortgage's claim for two of the defaults. These two defaults caused HUD a combined net loss of \$14 million. The third defaulted loan has an unpaid principal balance of \$12.6 million. As of April 29, 2005, HUD notified Suburban Mortgage the claim for insurance was denied for this loan. The risk of loss on this defaulted loan and two other identity-of-interest loans could cause HUD to lose an additional \$26.2 million. We also found that Suburban Mortgage's servicing failures contributed to unnecessary interest and penalties of \$229,673 from the late payment of real estate taxes.

What We Recommend

We recommend that HUD: (1) require reimbursement of \$229,673 for the unnecessary charges allowed by Suburban Mortgage, and (2) terminate the \$26.2 million in HUD-insured loans to the remaining three identity-of-interest properties. In addition, we recommend that HUD take appropriate administrative sanctions against Suburban Mortgage and its principals for its failure to perform its mortgage-related fiduciary duties.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

The auditee's narrative response, along with our evaluation of that response, can be found in appendix D of this report. The auditee also provided exhibits to support its position, but these exhibits were too voluminous to include in our report. We received these exhibits on June 7, 2005 and June 30, 2005.

³Throughout this report we use the term affiliated to refer to the identity-of-interest relationships or business ventures the executive vice president had with the six HUD-insured properties discussed in this report.

⁴ These three entities are Edmund Place Health Center, Coventry Health Center, and Hillside Health Center.

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BACKGROUND AND OBJECTIVES

The U.S. Department of Housing and Urban Development (HUD), through its subsidiary, the Federal Housing Administration, allows approved lenders to provide loans eligible for HUD-insured mortgages to private entities. This mortgage insurance provides lenders with protection against losses related to loan defaults. These loans must meet specific criteria outlined in the National Housing Act. Loans insured under Section 232 of the National Housing Act fund the construction and rehabilitation of residential health care facilities. Loans insured under Section 221(d)(4) of the National Housing Act fund new construction or substantial rehabilitation of multifamily rental or cooperative housing.

HUD's regulatory guidelines for these programs are contained within Title 24 of the *Code of Federal Regulations*. Each entity receiving a HUD-insured multifamily loan enters into a regulatory agreement with HUD. The regulatory agreement identifies many terms and conditions with which property owners must comply. HUD also provides guidance on lender responsibilities in the form of HUD directives and handbooks and through references contained in the *United States Code* and the *Code of Federal Regulations*. HUD guidance establishes requirements for approved lenders and entities receiving HUD-insured mortgages and prohibits certain business practices. Appendix B discusses specific guidance.

Suburban Mortgage Associates, Incorporated (Suburban Mortgage), is a HUD-approved lender with offices located at 4630 Montgomery Avenue, Bethesda, MD. In 1978, the president and the executive vice president created Suburban Mortgage and divided the ownership of the corporation between themselves and a second corporation with each entity receiving a third of the company. During our audit period, Suburban Mortgage had three members on its board of directors: (1) the president and chief executive officer, (2) the executive vice president, and (3) the partner of a law firm that provides legal counsel for Suburban Mortgage. Suburban Mortgage advised that its executive vice president terminated his role as a board member in November 2003, but was unable to provide his letter of resignation. Instead, Suburban Mortgage provided a copy of the minutes of the board of directors' meeting dated November 13, 2003 signed by the president of Suburban Mortgage. The replacement for the executive vice president is the attorney who has represented the executive vice president as a registered agent for several affiliated properties and companies. As of August 2003, Suburban Mortgage had used HUD insurance for 57 loans totaling \$314.3 million. Of this total, entities receiving 12 loans defaulted, causing HUD to pay Suburban Mortgage more than \$64 million, representing the outstanding amount of these loans at the time of default.

The executive vice president of Suburban Mortgage had multiple roles in its operation while also having multiple roles at entities receiving HUD-insured loans through Suburban Mortgage. During the audit period, the executive vice president also served as

- ▶ One of three board members for Suburban Mortgage,
- ▶ A consultant to Suburban Mortgage who is paid to originate loans,
- ▶ An ownership partner of four separate entities that received HUD-insured loans from Suburban Mortgage,
- ▶ The owner of a separate management company managing the individual properties that received the HUD-insured loans from Suburban Mortgage,
- ▶ The president or general partner of three service companies. These service companies have been paid by the properties that received their HUD-insured loans from Suburban Mortgage.

The executive vice president's four children also own and operate service companies and a management agent doing business with Suburban Mortgage and/or entities that received HUD-insured loans from Suburban Mortgage. Appendix C discusses these identity-of-interest relationships.

Our objective was to assess the performance of Suburban Mortgage in originating and servicing selected HUD-insured loans. During our audit, we also made special note of the involvement of affiliated entities receiving these loans and the extent to which affiliated companies and entities were transacting business with each other.

RESULTS OF AUDIT

Finding 1: Suburban Mortgage's Failure to Perform Its Fiduciary Responsibilities Caused Defaults and Unnecessarily Increased the Risk to HUD-Insured Loans

Suburban Mortgage failed to perform its fiduciary responsibilities for HUD-insured loans totaling \$62.8 million. Suburban Mortgage

- Allowed its executive vice president to ratify HUD-insured loans for properties in which he had an ownership interest.
- Paid the executive vice president for loan originations on HUD-insured loans for properties in which he had an ownership interest.
- Provided misleading and confusing information to HUD regarding identity-of-interest relationships involving the executive vice president of Suburban Mortgage and two mortgagors.
- Did not report to HUD cash distributions to owners of identity-of-interest properties with HUD-insured loans that it knew or should have known about.
- Failed to notify HUD of an identity-of-interest mortgagor's failure to pay the mortgage principal, required reserve for replacements deposits, and real estate taxes.

These conditions occurred because the management of Suburban Mortgage ignored prudent business practices and failed to follow proper management controls. As a result of these conditions, Suburban Mortgage

- (1) Cannot assure HUD of its compliance with applicable federal regulations,
 - (2) Caused HUD a \$14 million loss due to two⁵ defaulted loans that Suburban Mortgage originated for affiliated entities,
 - (3) Increased HUD's risk of loss on three remaining identity-of-interest, HUD-insured loans totaling \$26.2 million, and
 - (4) Permitted an affiliated entity to incur \$229,673 in unnecessary penalties.
-

⁵ The two loans are Coventry Health Center and Edmund Place Health Center.

Suburban Mortgage provided \$62.8 million in HUD-insured loans to affiliated entities as shown below.

Property	Location	Loan Amount	Date
Coventry Health Center	Coventry, RI	\$15,308,700	May 1994
Hillcrest Village	Providence, RI	5,752,800	June 1992
Hillside Health Center	Providence, RI	12,979,300	August 1998
Mount St. Francis Health Center	Woonsocket, RI	8,616,900	July 1995
Edmund Place Health Center	East Providence, RI	9,147,900	June 1995
Riverview Nursing Home	Coventry, RI	11,068,700	November 1996
Total		<u>\$62,874,300</u>	

Executive Vice President Ratifies Loans to Affiliated Entities

The executive vice president of Suburban Mortgage ratified two loans, insured by HUD, in which he had direct ownership interests: Coventry Health Center, and Hillcrest Village. The executive vice president also ratified one loan to Edmund Place Health Center that was managed by one of his children's companies. HUD regulations state that approved lenders (such as Suburban Mortgage) and any officer, partner, director, principal, or employee shall not be engaged in business practices that do not conform to generally accepted practices of prudent lenders or that demonstrate irresponsibility. Allowing the executive vice president to ratify these loans does not conform to prudent lending practices.

Executive Vice President Paid to Originate Loans to Entities that the Executive Vice President May Have Owned

HUD regulations prohibit payments by lenders such as Suburban Mortgage to persons associated with or receiving compensation from the owner. The executive vice president has ownership interest in four properties to which Suburban Mortgage provided HUD-insured loans. Financial records for two of these properties showed that the executive vice president received consideration from each property in his role as general partner of the ownership entity. Regulations state a mortgagee may not pay anything of value in connection with any insured mortgage transaction to any person or entity if such person has received any other consideration from the mortgagor for services related to the transaction. In this case, Suburban Mortgage paid commissions to the executive vice

president, who received a partnership interest from the mortgagor as part of the loan transactions.

Suburban Mortgage confirmed the executive vice president performed work as a loan originator for the company. From 2001 to 2003, Suburban Mortgage paid its executive vice president, as a consultant, approximately \$65,000 per year for loan origination services. Suburban Mortgage could not provide documents and records to specifically identify which loans the executive vice president originated.

Misleading Assertions by Suburban Mortgage Regarding Loan Recipients

Suburban Mortgage used traditional application procedures to process the six loans to affiliated entities. For these loans processed using traditional application procedures, Suburban Mortgage originated and serviced the loan while HUD underwrote the loan and approved it for insurance. For two⁶ loans, Suburban Mortgage certified that the loan to the identity-of-interest entity was not an identity-of-interest or was an arms-length transaction⁷. While an identity-of-interest relationship between the mortgagee and the owner is allowed per HUD regulations, it must be fully disclosed. We found the other loan was not an arms-length transaction. Appendix C delineates these misleading assertions.

⁶ These two loans were for Hillside Health Center and Mount Saint Francis Health Center.

⁷ See appendix B for definition of arms-length transaction.

Suburban Did Not Report Owner Distributions to HUD

Suburban Mortgage did not report to HUD cash distributions made to the owners of two identity-of-interest properties that Suburban knew or should have known about. Coventry Health Center and Mount Saint Francis Health Center paid out more than \$1.1 million to its general partner in loans and unearned fees while the properties were financially distressed. The general partner of each of these two entities is also the executive vice president of Suburban Mortgage. The audited financial statements received by Suburban Mortgage showed partners' fees to Coventry Health Center and Mount Saint Francis.

Coventry Health Center Payments in Fiscal Year Ended December 31, 1998	
Executive Service Fee	60,833
Loan	15,000
Total	\$75,883

Mount Saint Francis Health Center Payments in Fiscal Year Partners' fees.	
2000	201,600
2001	228,847
2002	301,003
2003	322,100
Total	\$1,053,550

These projects were financially troubled and carried significant account payables⁸. As the mortgagee, Suburban Mortgage should have reviewed annual financial statements⁹ to ensure that project funds were properly utilized for the stability of the project. Stability of the project benefits both HUD and the mortgagee. A mortgagee's quality control program must ensure that findings discovered by employees during the normal course of business are reported to HUD within 60 days of the initial discovery¹⁰. Our review of Suburban Mortgage's records noted that Suburban Mortgage personnel did not detect the cash distributions or question the necessity or the appropriateness of the payments. If Suburban Mortgage had sufficiently reviewed the independent public accountant

⁸ At December 31, 1999, Coventry Health Center had accounts payable of \$2,872,234. At December 31, 2002, Mount Saint Francis Health Center had accounts payable of \$1,673,000.

⁹ This requirement may be found in chapter 2 of the HUD Handbook 4350.4 Insured Multifamily Mortgagee Servicing and Field Office Remote.

¹⁰ This requirement may be found in chapter 6 of the HUD Handbook 4060.1 Mortgage Approval Handbook.

reports for these properties, the distributions could have been identified and reported to HUD. HUD then could have taken corrective action.

Additionally, mortgagees are required to report instances of fraud¹¹ or other abuses. Findings of fraud or other serious violations must be referred, in writing, to the director of the Quality Assurance Division. We found that, as general partner of Coventry Health Center and Mount Saint Francis Health Center, the executive vice president of Suburban Mortgage received distributions far in excess of surplus cash, which violates the regulatory agreement as well as federal regulations. As a general partner of the projects, the executive vice president signed the regulatory agreement and was aware, or should have been aware, of the regulatory requirements of the properties. Consequently, a principal of Suburban Mortgage had knowledge of a violation of federal regulations and was under an obligation to report it to HUD. We will address the specifics of violations found at Coventry Health Center and Mount Saint Francis Health Center in future reports related specifically to those properties.

Suburban Mortgage's executive vice president has a disincentive to provide HUD with accurate and complete information for HUD to take appropriate corrective action. Suburban Mortgage's executive vice president benefited from these cash disbursements. In addition to the payments noted above, the executive vice president or his companies received:

- Payment as a consultant from Suburban Mortgage to originate loans,
- Partnership fees from the properties to which Suburban Mortgage provided HUD insured loans, and
- Executive compensation from the properties to which Suburban Mortgage provided HUD insured loans.

Also, the executive vice president, his companies, and/or one or more of his children received payments from the properties they owned or were affiliated with and to which Suburban Mortgage provided HUD-insured loans. As owner of Suburban Mortgage, the executive vice president also benefited from the profits generated by the \$19 million in mortgage interest that Suburban received from these affiliated loans. Suburban Mortgage funds its loans through a series of warehouse lender lines of credit. During our audit period, the president and the executive vice president each personally guaranteed these warehouse lines of credit. Renewable annually, this line of credit began at \$1.5 million in 1996 and rose to \$3 million by 2003. Suburban Mortgage needs these lines of credit to have money available to loan. Therefore, given the personal guarantees

¹¹ This requirement may be found in chapter 6 of the HUD Handbook 4060.1 [Mortgage Approval Handbook](#).

of the president and executive vice president, each had the ability to significantly influence the operations of Suburban Mortgage.

Failure to Notify HUD of Delinquent Mortgage and Reserves Payments

Suburban Mortgage's loan records for Hillside Health Center showed that this identity-of-interest company did not pay the mortgage principal or submit deposits for the reserve for replacement account from August 1999 until March 2003. Initially, Suburban Mortgage claimed that HUD allowed Hillside Health Center to defer the mortgage principal payments and the reserve deposits in 1999. Later, Suburban Mortgage's management acknowledged that no request was made of HUD for the deferral of these payments. As of February 2003, the delinquent principal payments totaled \$229,722, and the delinquent deposits to the reserve for replacement account totaled \$597,883. Hillside Health Center informed Suburban Mortgage in August 1999 that it was unable to pay the mortgage principal or the deposits for the reserve for replacement account and requested that these payments be deferred until the final endorsement. The final endorsement never took place, and the Hillside Health Center went into receivership in March 2004. Suburban Mortgage requested assignment of the Hillside Health Center's \$12 million mortgage to HUD in June 2004. HUD denied the claim in April 2005. Suburban Mortgage's failures to obtain HUD approval or otherwise appropriately advise HUD of the deficiency precluded HUD from taking appropriate corrective action and possibly preventing the assignment.

Suburban Did Not Assure Payment of Real Estate Taxes

In September 1999, Hillside Health Center notified Suburban Mortgage that it would pay all real estate taxes. While Suburban Mortgage received notices of unpaid real estate taxes for Hillside Health Center from the City of Providence for tax years 1999, 2000, and 2001, Suburban Mortgage did not take action to ensure that Hillside Health Center paid the taxes when due. After receiving the overdue notices for each year, Hillside Health Center established payment plans to pay the overdue taxes.

Due to the lack of timely payments, the city added \$229,673 in additional interest charges as shown in the following table.

Tax year	Taxes assessed	Taxes paid	Interest charged
1999	\$207,308	\$239,768	\$32,460
2000	\$293,296	\$333,048	39,752
2001	\$313,194	\$340,998	27,804
2002	\$330,384	\$460,041	<u>129,657</u>
Total			<u><u>229,673</u></u>

Upon inquiry, Suburban Mortgage advised that it did not consider these taxes overdue because of Hillside Health Center's payment plans. Suburban Mortgage believed there was no need to notify HUD of these developments.

Prudent Lending Practices

To identify whether the mortgages to affiliated entities represented prudent mortgage lending practices, we contacted members of the mortgage banking industry to obtain their comments as to the propriety and appropriateness of these relationships. Without identifying the names or locations of any persons, entities, or businesses involved, we asked the representative for their comments on the relationship noted in our review. The representative commented that

- The situations described did not represent proper arms-length transactions and this issue should be examined further.
- Significant risks existed in relation to the mortgage loans identified. This was due to the lack of proper arms-length relationships, as noted.
- Although the situations described were not explicitly prohibited by HUD's regulation and guidelines¹², these situations were unusual and were not common or customary within the industry.
- The general standards applicable to the situations described were prudence and appropriateness on the part of the lender in performing its mortgage lending business practices.

¹² Although HUD regulations do not prohibit identity-of-interest relationships, HUD regulations at 24 CFR 202.5(j) do require that neither the lender or mortgagee, nor any officer, partner, director, principal or employee of the lender or mortgagee shall be engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility.

- The requests for loans (and the underlying loan insurance from HUD) should have been refused at the time they were made. HUD should terminate the insurance for these loans.

We also contacted the State of Maryland – the Office of the Commissioner of Financial Regulation regarding the identity-of-interest scenarios. Again, our purpose was to obtain independent comments from a state regulatory authority that oversees mortgage companies in Maryland. As in the case of the mortgage banking representative, we did not identify the names of any persons, entities, or businesses involved; however, we did indicate that we were inquiring about a mortgage company within the State of Maryland. In response to our request, the office advised

- ◆ None of the transactions were arms-length in nature.
- ◆ Subsequent transactions between the lender, owner, and affiliated companies were unusual and were not customary in the mortgage banking industry.
- ◆ The fact that the executive vice president of Suburban Mortgage is also involved in ownership of various entities that provided services to the nursing homes is a cause for concern.
- ◆ Had HUD been in possession of all the facts surrounding the executive vice president's involvement in the nursing homes and service providers, HUD's decision on these loans might have been different.

From the statements made by the mortgage banking representative and state regulatory official, we concluded that the transactions between Suburban Mortgage, as the lender, and the owners were not arms-length in nature. In addition, the relationships among the various entities identified are not customary within the mortgage banking industry and do not represent prudent and appropriate practices.

Suburban Mortgages' Failures Lost HUD Millions

Three of the six mortgages that Suburban Mortgage provided to properties owned by or affiliated to its executive vice president defaulted on their HUD-insured loans. Suburban Mortgage requested assignment of the three loans to HUD. HUD paid Suburban for two loans and denied the claim¹³ on the third, which effectively terminates the insurance. After

¹³ Suburban Mortgage has filed a suit against HUD regarding HUD's decision to deny the \$12 million insurance claim for Hillside Health Center. The outcome of this suit is unknown.

paying two of the claims, HUD took over the mortgage note and allowed the sale of the property. HUD incurred a combined net loss of \$14,003,674 on the sale of these two mortgage notes.



Name	Original mortgage	Unpaid principal	Loss on sale
Coventry Health Center	\$15,308,700	\$15,120,597	\$6,292,520 ¹⁴
Edmund Place Health Center	\$9,147,900	\$8,935,730	\$7,711,154
Total	\$24,456,600	\$24,056,327	\$14,003,674

Suburban Mortgage failed to act in a proper fiduciary capacity and thereby protect HUD from unacceptable risk of loan default. HUD should pursue Suburban Mortgage for the recovery of these losses.

HUD is at risk of incurring additional losses from defaults on the four loans to affiliated entities. HUD could lose the outstanding balance of \$26.2 million that Suburban Mortgage loaned to the identity-of-interest properties of Hillside Health Center, Hillcrest Village, and Mount Saint Francis Health Center. HUD could also lose the outstanding balance of \$11.1 million that Suburban Mortgage loaned to the affiliated property of Riverview Nursing Home. To alleviate the increased risk on the remaining four loans, HUD should terminate the loan insurance on the identity-of-interest loans. HUD should also withdraw Suburban Mortgage's approval to participate in its mortgage insurance programs to preclude any recurrence of the conditions cited in this report.

Referral to the Mortgagee Review Board

HUD notified Suburban Mortgage of the following violations in a letter, dated January 30, 2003:

-  Suburban Mortgage accepted interest-only payments from the mortgagor of Hillside Health Center beginning in August 1999 and failed to inform HUD until January 2003 that the mortgage principal payments were delinquent; and
-  The mortgagor did not make the required deposits to the reserve for replacement account beginning in August 1999, and the lender failed to notify HUD that these deposits were delinquent.

¹⁴ In a separate report, dealing exclusively with Coventry Health Center, the Office of Inspector General (OIG) will recommend that HUD pursue recovery of the loss of \$6,292,520 from the former owners of Coventry Health Center. The executive vice president of Suburban Mortgage was the part of the ownership entity.

In addition, the local HUD office referred Suburban Mortgage on February 10, 2003, to HUD's Mortgagee Review Board, requesting the imposition of sanctions against Suburban Mortgage as the lender for the Hillside Health Center property. The Mortgagee Review Board oversees the performance of lenders participating in Federal Housing Administration insurance programs.

On February 20, 2003, Suburban Mortgage notified HUD that Hillside Health Center had entered into payment plan agreements with the City of Providence for the 2000, 2001, and 2002 real estate taxes; but the agreements did not address the taxes for 1999. In response, HUD sent a supplemental violation notice, on February 27, 2003, to Suburban Mortgage that included the failure to (1) collect real estate tax escrows for the property commencing in 1999 and (2) report these tax delinquencies to HUD in a timely manner.

Conclusion

Suburban Mortgage did not adequately perform as an approved lender in HUD's multifamily mortgage insurance program by failing to carry out all of its fiduciary responsibilities. Suburban Mortgage, along with affiliated entities, provided misleading, confusing, and conflicting information to HUD for affiliated properties in which the executive vice president of Suburban Mortgage had an interest. As a result, HUD lacked a complete and thorough understanding of the identity-of-interest interrelationships between the affiliated parties and entities involved with the properties. Without proper information regarding identity-of-interest relationships and timely notification of default, HUD was prevented from taking corrective remedial actions. Suburban Mortgage's failures caused \$14 million in losses to HUD and put another \$26.2 million of HUD funds at unnecessarily increased risk. HUD should take administrative sanctions against Suburban Mortgage and its principals for its failure to perform its mortgage-related fiduciary duties.

Recommendations

We recommend that HUD's assistant secretary for housing-federal housing commissioner

- 1A. Require Suburban Mortgage and the owners of the Hillside Health Center to reimburse \$229,673 for the interest charges incurred from the late payment of the real estate taxes¹⁵.
- 1B. Terminate the insurance for the three remaining loans to identity-of-interest affiliated properties—Hillside Health Center, Hillcrest Village, and Mount Saint Francis Health Center—estimated to be \$26.2 million¹⁶.

We also recommend that HUD's assistant secretary for housing-federal housing commissioner, in conjunction with the director of HUD's Departmental Enforcement Center,

- 1C. Take appropriate administrative sanctions against Suburban Mortgage and its principals for its failure to perform its mortgage-affiliated fiduciary duties.

¹⁵ Suburban Mortgage has filed a suit against HUD regarding HUD's decision to deny the insurance claim for Hillside Health Center. The outcome of this suit is unknown. If HUD prevails, HUD will not seek repayment and Recommendation 1A will be closed.

¹⁶ The claim and lawsuit for Hillside Health Center affects Recommendation 1B also. If HUD prevails, Recommendation 1B will be decreased by the \$12 million associated with the Hillside Health Center claim.

SCOPE AND METHODOLOGY

The scope of our review included selected HUD-insured loans provided by Suburban Mortgage for various HUD-insured properties in New England. At the time these loans were initiated, Suburban Mortgage processed loans using traditional application procedures, with HUD performing the underwriting function for the loans. Later, Suburban Mortgage began using multifamily accelerated processing, whereby it performed all of the loan functions including underwriting.

To accomplish our audit objectives, we performed onsite work from October 2003 to April 2004. During the audit, we reviewed federal requirements including Title 24 of the *Code of Federal Regulations*), HUD's handbooks and directives, and records of Suburban Mortgage, including the minutes of its board of directors' meetings. We also searched state records of Rhode Island and Maryland to obtain background information on Suburban Mortgage and affiliated entities. We interviewed HUD multifamily housing personnel and the management and staff of Suburban Mortgage to obtain information on its internal controls, applicable to the origination and servicing functions performed for selected loans, and performed general risk assessments of these loan functions.

We identified a population of 57 HUD-insured loans valued at \$314 million processed by Suburban Mortgage. Of the 57 loans, we selected six loans for review. Four of these loans had identifiable identity-of-interest relationships between the mortgagors and the executive vice president of Suburban Mortgage and two loans were affiliated through business ventures with the executive vice president of Suburban Mortgage. For the six loans, we reviewed loan origination and servicing functions at HUD's Providence field office and at Suburban Mortgage and examined affiliated records to determine whether these procedures complied with HUD's regulations.

We also obtained information from the City of Providence, Rhode Island, regarding the real estate taxes for Hillside Health Center. We determined the timing of these tax payments and the amount of interest and penalties paid by Hillside Health Center's owners. We contacted mortgage banking industry representatives and a State of Maryland banking regulatory official to obtain relevant information regarding the identity-of-interest/conflict-of-interest issues involving Suburban Mortgage and affiliated parties/entities noted during our review.

The audit covered the period from January 1, 2001 through December 31, 2003. When appropriate, the audit was extended to include other periods. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Suburban Mortgage's controls over loan origination.
- Suburban Mortgage's controls over loan servicing.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following are significant weaknesses (see finding 1):

- Suburban Mortgage did not have controls to prevent one of its board members from ratifying HUD-insured loans for properties in which this board member had an ownership interest.
- Suburban Mortgage did not have controls to ensure its board member was not paid for loan origination work on HUD-insured loans where the member received a partnership interest.

- Suburban Mortgage did not have controls to ensure information provided to HUD regarding identity-of-interest relationships involving Suburban Mortgage and mortgagors was complete and accurate.
- Suburban Mortgage did not have procedures in place to ensure HUD-insured properties' annual financial statements are adequately reviewed and irregularities are reported to HUD.
- Suburban Mortgage did not have controls in place to ensure HUD was notified of a mortgagors' failure to pay mortgage principal, reserve for replacements deposits, or real estate taxes.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Ineligible 1/	Funds to be put to better use 2/
1A	\$229,673 ¹⁷	
1B		\$26,256,580 ¹⁸
Totals	<u>\$229,673</u>	<u>\$26,256,580</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures later for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

¹⁷ Suburban Mortgage has filed a suit against HUD regarding HUD’s decision to deny the insurance claim for Hillside Health Center. The outcome of this suit is unknown. If HUD prevails, HUD will not seek repayment and Recommendation 1A will be closed.

¹⁸The claim and lawsuit for Hillside Health Center affects Recommendation 1B also. If HUD prevails, Recommendation 1B will be decreased by the \$12 million associated with the Hillside Health Center claim.

Appendix B

DEFINITIONS

Arms-length transactions - Arms-length transactions are business dealings in which each involved party acts independently of each other involved party. In arms-length transactions, neither party is subject to the other's influence or control. For affiliated entities and identity-of-interest entities to be considered arms-length, the entities must behave in their dealings or arrangements as if there were two unrelated parties. In addition, HUD guidance stipulates that approved lenders (and any officer, partner, director, principal, or employee thereof) shall not be engaged in business practices that do not conform to generally accepted practices of prudent lenders or that demonstrate irresponsibility. Prudent lending practices dictate that transactions be arms-length in nature.

Conflict of interest – 24 CFR 202.5(l), A mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction or transactions to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgaged property, except that consideration approved by the secretary of HUD may be paid for services actually performed. The mortgagee shall not pay a referral fee to any person or organization.

Fiduciary responsibilities - HUD Handbook 4350.4, "Insured Multifamily Mortgagee Servicing and Field Office Remote," discusses the principles of fiduciary responsibilities. An entity acts in a "fiduciary capacity" when the business being transacted or the money/property being managed is not for the benefit of the entity but for the benefit of another person/entity. The relationship between the two parties involves great confidence, trust, and a high degree of good faith. In a fiduciary relationship, neither party may (1) exert influence or pressure upon the other, (2) take selfish advantage of this trust, or (3) deal with the subject matter of the trust in such a way as to benefit (the entity) or prejudice the other (entity) except in the exercise of the utmost good faith and with the full knowledge and consent of that other (entity). Business shrewdness, hard bargaining, and astuteness to take advantage of the forgetfulness or negligence of another are totally prohibited between parties (entities) standing in a fiduciary relationship to one another.

Identity-of-interest - In relation to HUD programs, an identity-of-interest relationship is defined as existing between two parties (entities) when, for the first entity, either

- (a) The owner entity or a general partner of the owner entity or
- (b) Any officer or director of the owner entity or
- (c) Any person who directly or indirectly controls 10 percent or more of the voting rights or owns 10 percent or more of the owner entity

is also one of the following of the second entity:

- (a) An owner, general partner, officer, or director or
- (b) A person who directly or indirectly controls 10 percent or more of the voting rights or owns 10 percent or more of the owner entity.

In this definition, a “person” refers to any individual, partnership, corporation, or other business entity. Any ownership, control, or interest held or possessed by a person’s spouse, child, grandchild, sibling, or other relation by blood or marriage is attributed to that person for this determination.

Absolute independence in decision-making and in business practices is rarely an attainable goal; however, conflicts can often be resolved or remedied by actions such as

- Adequate disclosure of conflicts,
- Removal of persons with identified conflicts from decision-making and from roles of authority, and
- Divestiture of ownership and affiliated interests.

Mortgagee approval - HUD Directive 4060.1, “Mortgagee Approval Handbook,” requires lenders to design programs that meet the goals of (1) assuring compliance with HUD’s requirements; (2) protecting the lender and HUD from unacceptable risk; (3) guarding against errors, omissions, and fraud; and (4) assuring swift and appropriate corrective action.

Mortgage payments and defaults - 24 CFR [*Code of Federal Regulations*] 200.84, “Mortgagor Payment Requirements,” requires that mortgage agreements provide for the owner to pay to the lender equal monthly payments to amortize all taxes (among other items). The mortgage shall further provide that such payments be held by the lender for paying the taxes before the taxes become delinquent. HUD defines a “mortgage default” as the failure of the owner to make any payment due under the mortgage or the failure to perform any other covenant under the provisions of the mortgage [24 CFR 207.255]. HUD also requires that if the mortgage default (as defined) is not cured within the 30-day grace period, the lender must notify HUD within 30 days of such default [24 CFR 207.256]. Further, HUD requires the lender to certify that it will follow HUD’s terms, conditions, and requirements associated with the HUD-insured loan [24 CFR 200.51].

Oversight of mortgagors - HUD’s regulations governing Federal Housing Administration insurance programs provide for oversight of owners by means of a regulatory agreement. The

regulatory agreement requires that owners be prohibited from paying out any property funds except for reasonable operating expenses and necessary property repairs. The regulatory agreement also states that property owners shall not transfer any personal property of the property without prior HUD approval.

Owners' advances - HUD Handbook 4370.2, "Financial Operations and Accounting Procedures for Insured Multifamily Properties," states that owner advances made for reasonable and necessary operating expenses may be repaid from surplus cash at the end of the annual or semiannual period. These regulations also prohibit repayments of owner advances when a property is in a non-surplus-cash position.

Payments by mortgagees - In 24 CFR [*Code of Federal Regulations*] 202.5, "Approval of Lending Institutions and Mortgagees," HUD prohibits certain business practices on the part of its approved lenders. These regulations specifically prohibit payments by the lender to persons associated with and receiving compensation from the owner(s).

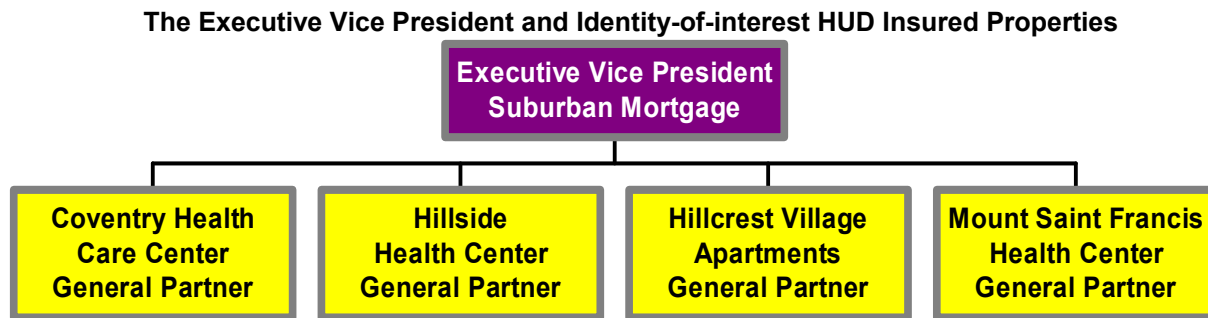
Review by mortgagees - HUD Handbook 4350.4, "Insured Multifamily Mortgage Servicing and Field Office Remote," provides that lenders should always review monthly or annual revenue and expense statements from the owner and compare them with previous statements. Analysis of these statements may identify conditions leading to delinquencies that could be prevented. For delinquent mortgage loans, the lender needs to determine the causes of the delinquency, including improper financial operations, such as payments to owners, loans to owners or other properties, or excessive costs, particularly when identity-of-interest vendors are involved.

Surplus cash - Surplus cash, as defined in the regulatory agreement, is the cash remaining after the payment of (1) all sums due or currently required to be paid under the terms of any HUD-insured loan, (2) all amounts required to be paid into the reserve for replacements, and (3) all obligations of the project other than the HUD-insured loans (unless deferment of this obligation has been approved by the secretary of housing and urban development) and the segregation of special funds required to be maintained by the project and tenant security deposits.

Appendix C

Affiliated Entities

As noted in our finding, the executive vice president had affiliated interests in six properties that received loans from Suburban Mortgage. Suburban Mortgage provided four HUD insured loans to identity-of-interest properties, as shown in the following chart.



Coventry Health Center - The executive vice president of Suburban Mortgage was a general partner in Coventry Health Center Associates, a limited partnership that owned the property. On February 19, 2001, the State of Rhode Island placed Coventry Health Center in receivership.

Hillside Health Center - The executive vice president of Suburban Mortgage was a limited partner in Hillside Health Center Associates, a limited partnership that owned Hillside Health Center. The general partner of this partnership was Consultants, Incorporated, a real estate consulting firm in which the executive vice president has an affiliation. According to the limited partnership documents for Hillside Health Center Associates, the executive vice president's percentage interest in the partnership profits and losses was 99 percent. The State of Rhode Island placed Hillside Health Center into receivership in March 2004. Suburban requested assignment of Hillside Health Center's mortgage. This claim was denied by HUD in April 2005. A lawsuit has been filed by Suburban to force HUD to pay the claim. For this loan, Suburban Mortgage added a rider to the mortgagee's certificate that stated that: (1) the executive vice president has an interest in the mortgagor (Hillside Health Center) as revealed in the agreement and certificate of limited partnership; (2) additionally, the executive vice president has an interest in the mortgagee (Suburban Mortgage); and (3) however, this transaction is an arms length transaction and neither the mortgagor nor the mortgagee has a controlling interest in the other.

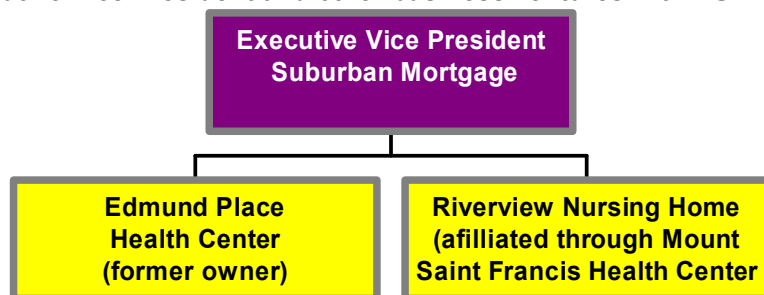
Hillcrest Village - The executive vice president of Suburban Mortgage was a general partner in Hillcrest Village Associates, a limited partnership that owned Hillcrest Village. Hillcrest Village's management agent, Management Realty Services, was a consulting firm in which one of the executive vice president's children and two business associates of the executive vice president were principals. Hillcrest Village also received rental subsidies from HUD.

Mount Saint Francis Health Center - The executive vice president of Suburban Mortgage was a general partner in Mount Saint Francis Associates, a limited partnership that owned Mount Saint

Francis Health Center. The limited partner of Mount Saint Francis Health Center was another limited partnership whose general partner was also the president of Riverview Nursing Home, Incorporated (the limited partnership that owned Riverview Nursing Home).

Suburban Mortgage provided two HUD insured loans to affiliated properties, as shown in the following chart.

The Executive Vice President and other business ventures with HUD Insured Properties



Edmund Place Health Care Center - The executive vice president of Suburban Mortgage did not participate in the ownership of Edmund Place at the time of HUD insurance and default. According to records obtained from the State of Rhode Island, the executive vice president was part of the partnership from 1981 to 1989. The loan received initial endorsement from HUD in December 1993. The executive vice president's identity-of-interest management agent, Sterling Health Care Management, managed the property for the owners who defaulted.

Riverview Nursing Home - The executive vice president of Suburban Mortgage did not participate in the ownership at Riverview Nursing Home. The president of Riverview Nursing Home, Incorporated (the limited partnership that owned Riverview Nursing Home), was also a general partner of the limited partnership that owned Mount Saint Francis Health Center.

Other Affiliated Companies

During our audit of Suburban Mortgage, we identified numerous companies that the executive vice president of Suburban Mortgage and/or one or more of his children had an ownership interest. These companies, listed below, were doing business with one or more of the affiliated properties to which Suburban Mortgage provided HUD-insured loans.

Consultants, Incorporated - This company provided real estate management consulting services to the following affiliated properties: Coventry Health Center, Edmund Place Health Center, Hillside Health Center, and Riverview Nursing Home. We were unable to determine actual ownership. However, in March 2003, Consultants, Incorporated, reported to the State of Rhode Island that two of the executive vice president's children were principals in Consultants, Incorporated. A July 2003 Dun & Bradstreet report identified Consultants, Incorporated, as a subsidiary of a consulting firm named for the executive vice president. This report also identified the executive vice president of Suburban Mortgage as the president of Consultants, Incorporated. The Dun & Bradstreet information on Consultants, Incorporated, conflicts with the information provided to HUD. The affiliated owners for three of the four properties, to

which Consultants, Incorporated, provided services, defaulted on their HUD-insured loans. The State of Rhode Island placed two of these properties into receivership. Consultants Inc. was also the general partner of the ownership entity of Hillside Health Center.

Management Realty Services - This company managed Hillcrest Village. Management Realty Services is a consulting firm in which two of the executive vice president's children and one of the business associates of the executive vice president are principals.

My Place, Incorporated - This company provided human resource/employee benefit services to at least two affiliated properties: Coventry Health Center and Mount Saint Francis Health Center. One of the executive vice president's children is a principal in My Place, Incorporated.

Simon & Windsor Interiors, Incorporated - This company provides interior decorating services to at least two affiliated properties: Coventry Health Center and Mount Saint Francis Health Center. Two of the executive vice president's children are principals in Simon & Windsor Interiors, Incorporated.

Sterling Health Care Management - This firm is a health care management company that performed as the management agent for Coventry Health Center, Edmund Place Health Center, and Mount Saint Francis Health Center. At various points in time, the executive vice president and/or three of his children were identified as principals for Sterling Health Care Management.

Affiliated Entities Provided Misleading Information to HUD

The executive vice president and affiliated entities provided misleading, confusing, and conflicting information to HUD, including the following:

- For the Mount Saint Francis loan, the executive vice president signed a declaration that stated, "I hereby certify that there is no identity-of-interest to any of the parties involved in this proposal, i.e., contractor, architect, mortgagee." The executive vice president signed this declaration as the general partner of the partnership owner. This statement conflicted directly with the fact that the executive vice president also co-owned Suburban Mortgage.
- In May 1995, Suburban Mortgage sent a letter to HUD certifying that Suburban Mortgage had no interest in the owner of Mount Saint Francis Health Center, and the owner of Mount Saint Francis Health Center had no interest in Suburban Mortgage. While technically correct, these statements were misleading since the executive vice president is the co-owner of Suburban Mortgage and the general partner of the partnership owning Mount Saint Francis Health Center and that relationship was not disclosed.
- Documents related to the application of the loan insurance for the Mount Saint Francis Health Center showed several instances in which both the executive vice

president and the president of Suburban Mortgage signed the same documents but represented different entities. In these instances, the president signed on behalf of Suburban Mortgage while the executive vice president signed as the general partner for the partnership that owned Mount Saint Francis Health Center. Without knowing the relationship of these two individuals and their joint ownership of Suburban Mortgage, outside observers could not identify that these transactions occurred between affiliated parties.

- For the Hillside Health Center loan, the July 1998 mortgagee certificate contained a rider stating that the executive vice president has an interest in Hillside Health Center and an interest in Suburban Mortgage. The rider further stated that this transaction is an arms-length transaction and neither Suburban Mortgage nor Hillside Health Center has a controlling interest in the other. This statement is misleading since it does not identify that the executive vice president owns 50 percent of Suburban Mortgage and personally guarantees the \$3 million warehouse line of credit that keeps Suburban in business. Interests between affiliated entities need not be controlling to demonstrate significant influence. As a main investor in the mortgagor entity, the executive vice president's relationship with Suburban Mortgage was material and significant. Based on the servicing of the loan, as shown in this report, the lender did not treat this transaction as arms-length in nature.

Appendix D

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

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HUD - OIG
OFFICE OF AUDIT
BOSTON, MASSACHUSETTS

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June 6, 2005

Ms. Cris O'Rourke
Assistant Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
10 Causeway Street, Room 370
Boston, Massachusetts 02222-1094

Re: Audit Report No. 2005-BO-100X

Dear Ms. O'Rourke:

This letter sets forth the comments of Suburban Mortgage Associates, Incorporated ("Suburban") in response to a draft audit report on certain FHA-insured loans that Suburban made ("Draft Report"). Suburban was invited to comment on the above-referenced draft audit report by Mr. John Dvorak in a letter dated May 11, 2005 and received by Suburban on May 16, 2005. Mr. Dvorak's letter requested a response by May 26, 2005. Suburban promptly requested a 45 day extension, but Mr. Dvorak only granted a 15 day extension. This means that Suburban has had only 25 days to prepare comments on the Draft Report, although the Office of Inspector General ("OIG") began working on this review in 2003, almost 18 months ago.

The Draft Report notes that OIG reviewed eight of Suburban's FHA-insured loans and discusses six of those loans. It notes that on one of these loans, Suburban failed to report certain defaults by the Mortgagor and to obtain HUD approval for an effort to avoid assignment of the loan. However, it does not note that Suburban's failure to report was due to its mistaken belief that it had done so and had obtained authorization to defer certain payments, nor does it acknowledge that Suburban informed HUD of this default as soon as it learned of its own mistake.

Aside from recognizing this one already acknowledged mistake, the Draft Report misapprehends the facts, misunderstands the law, and ignores how FHA's multifamily insurance program works. Although it cites with approval statements by mortgage bankers that "...the situations described were not explicitly prohibited by HUD's regulations and guidelines, ..." (Draft Report, p. 12), it does not draw the inevitable conclusion that must follow from this statement: that these "situations" provide no basis for attacking Suburban.

The Draft Report ignoring how the program works is particularly disturbing. First, it ignores the differing responsibilities of a mortgagee and of HUD in the management of insured loans. HUD Handbook 4350.1 REV-1 makes it blindingly clear that enforcement of Regulatory Agreement provisions, which the Draft Report chastises Suburban for not enforcing, is the exclusive responsibility of HUD. In addition, the responsibilities of the mortgagor and mortgagee are different. The Draft Report improperly attempts to graft various mortgagor's responsibilities and

Comment 1

Comment 2

Washington DC | Northern Virginia | Dallas | Denver | Anchorage | Doha, Qatar



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Comment 3

duties onto Suburban. Further, the report ignores the common practice of nursing homes having an operator, which leases the premises from the mortgagor. In such cases, a separate Regulatory Agreement, which is not identical to the mortgagor's Regulatory Agreement, is executed by HUD and the lessee. Thus, a mortgagee has no privity with the lessee, so that the burden of enforcing that Regulatory Agreement is entirely and indisputably upon HUD.

Second, the Draft Report equates identity-of-interest payments with "improper cash distributions" and faults Suburban for not taking action to stop them. The Draft Report offers no proof as to why such payments are "improper" and indeed could not do so. In fact, it is only the Draft Report's assertion that identity-of-interest payments are "improper" cash distributions that is improper. Nor should Suburban be faulted for not stopping these payments even if they were improper. It is HUD's responsibility to maintain the financial soundness of the mortgagor entity. *See* HUD Handbook 4350.1 REV-1, ¶ 1-10.

Comment 4

Indeed, much of the Draft Report's condemnation of Suburban springs from its obvious distaste for identity-of-interest transactions and payments to identity-of-interest entities. The more honest course of action for dealing with identity-of-interest payments would be for OIG to address these concerns with the Office of Housing and the Office of General Counsel so that HUD requirements concerning identity-of-interest can be changed appropriately. OIG should not try to establish unwritten OIG requirements, which are contrary to existing housing policy and which OIG wants to apply retroactively, to a mortgagee who has complied with all applicable lawful requirements.

Comment 5

It may be that OIG's distaste for identity-of-interest results from confusion between Traditional Application Procedures ("TAP"), under which the loans in question were processed, and Multifamily Accelerated Processing ("MAP"). Due to the totally different way in which MAP loans are processed, the MAP Guide, at 2.5, flatly prohibits identity-of-interest transactions and payments for MAP loans. This is a significant deviation from the customary practice of allowing identity of interest parties to participate in TAP loans.

Comment 6

Third, the report makes much of certain transactions not being "arm's length transactions." With all due respect to these assertions, there is no such thing in the statute or in relevant HUD regulations and guidance. There is no requirement that the parties act at arm's length nor is there even a definition of "arm's length transaction" in applicable HUD regulations or guidance. Thus, this complaint about Suburban amounts to an additional effort to force it to comply retroactively with non-existent requirements.

Fourth, the Draft Report boldly asserts that Suburban "has a disincentive to provide HUD with accurate and complete information..." That assertion is completely false. Failure to provide HUD with information so that it can take corrective action is a prescription for default and assignment or foreclosure. Even in the best circumstances in such a situation, the mortgagee is severely affected financially. As a result, a mortgagee such as Suburban has an incentive, not a disincentive, to report fully to HUD.

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Beyond its specific shortcomings, ultimately the Draft Report is nothing more than an attempt to justify HUD's refusal to accept assignment of the Hillside Mortgage. Courts have warned HUD that it must use the regulatory process to advance "solutions" to perceived problems in national housing policy. See *Patriot, Inc. v. U.S. Dep't of Housing and Urban Development*, 963 F.Supp. 1 (D.D.C. 1997) ("...the Court will instruct [HUD] again: HUD is not free to ignore the requirements of the [Administrative Procedure Act] in its haste to address perceived problems in the realm of national housing policy..." (emphasis added)).

Based on an almost completely erroneous recitation, the Draft Report reaches conclusions that cannot be sustained and recommendations that cannot be justified. These errors will be discussed in greater detail below. At this point, it suffices to note that the report is so flawed as to require its withdrawal and complete revision. Although these comments do not address every inaccuracy and fallacy in the Draft Report, that should not be interpreted as Suburban's acquiescence in such statements.

These comments first examine the factual assertions, legal analysis, and program descriptions found in the Draft Report. Conclusions and recommendations which are at pages 2-3, 7, and 15-16 and 18-20, are discussed later. For ease of comprehension, the following comments utilize the headings and subheadings in the Draft Report. Their use, however, should be considered solely a reader's aid and not any indication of any agreement with either the title or the subject matter.

BACKGROUND AND OBJECTIVES

In setting forth the background that forms the apparent basis for initiating this review, the audit report makes several mistakes of fact. First, as is shown in the Affidavit of J. Walsh Richards, Jr. attached as Exhibit 1 ("Richards Aff.") at ¶ 4, Suburban Bancorp was an original stockholder of Suburban and remained a stockholder until 1984.

Second, it asserts that

As of August 2003, Suburban Mortgage had used HUD insurance for 57 loans totaling \$314.3 million. Of this total, entities receiving 29 loans defaulted, causing HUD to pay Suburban Mortgage more than \$140 million, representing the outstanding amount of these loans at the time of default.

Draft Report, p. 5. This assertion clashes violently with reality. Suburban, in fact, has used FHA insurance for 121 loans totaling \$695,080,558 million. Of this total, entities having 13 loans defaulted, causing HUD to pay mortgage insurance proceeds of \$72,479,200. Richards Aff. at ¶¶ 6-7. (Of course, HUD received in return the mortgage notes, which it disposed of, thereby significantly reducing the loss.)

Comment 8



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Comment 9

Finally, the audit report is both confusing and inaccurate in its description of the roles played by the Executive Vice President ("EVP") of Suburban. *See* p. 6. (For ease of reference, this individual will be referred to as the EVP. However, he has not held this position at Suburban or been an officer or director of Suburban since late 2003. Richards Aff. at ¶ 5.) With respect to the five "bullets" that set forth his alleged roles, it should be noted that the first and second -- Suburban Board membership and consultancy -- are no longer the case. *Id.* With respect to the third and fifth bullets, the allegations are so vague and the time frame so uncertain as to make it impossible to respond. Finally, one of the two "separate management companies" referred to in the fourth bullet has never been owned by the EVP, and he has not owned the other for a number of years. Affidavit of Cristine Bowes attached as Exhibit 2 ("Bowes Aff.") at ¶¶ 2-3.

RESULTS OF AUDIT

At p. 8, the report lists six properties that it asserts are "owned by or related to" Suburban's EVP. The proper standard is not "owned by or related to" but is identity-of-interest, which is defined in Appendix B at p. 22:

Identity of Interest--In relation to HUD programs, an identity-of-interest relationship is defined as existing between two parties (entities) when, for the first entity, either

- (a) the owner entity or a general partner of the owner entity or
- (b) any officer or director of the owner entity or
- (c) any person who directly or indirectly controls 10 percent or more of the voting rights or owns 10 percent or more of the owner entity.

Is also one of the following of the second entity:

- (a) an owner, general partner, officer, or director or
- (b) a person who directly or indirectly controls 10 percent or more of the voting rights or owns 10 percent or more of the owner entity.

Identity-of-interest arrangements are permitted by HUD so long as they are disclosed and approved. This is contrary to the position taken by the Draft Report inasmuch as it repeatedly equates payments to identity-of-interest entities with "improper cash distributions." Further, the listing of projects which allegedly involve identity-of-interest loans (p. 8) is not correct.



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Comment 10

First, Edmund Place is not nor has it ever been an identity-of-interest loan. In Appendix C at p. 24, the audit report attempts to tie the EVP into ownership of Edmund Place through a letter from the City of East Providence, Rhode Island. However, the facts are different from this tortured assertion. The EVP was originally a general partner and a limited partner in Edmund Place Associates, which ultimately became the mortgagor of this project. However, the EVP withdrew from this partnership and terminated his status as a partner in it on June 19, 1989.¹ The Edmund Place loan did not go to final endorsement until December 1993, which was 4½ years after the EVP's withdrawal and 3½ years after the document was filed with Rhode Island. Since HUD guidance clearly requires a contemporary relationship ("Is one of the following of the second entity..." (emphasis added)), there is no identity of interest here. Similarly, Riverview Nursing Home was never an identity-of-interest loan. The Draft Report, Appendix C at p. 25, acknowledges that the EVP did not have an ownership interest in Riverview but attempts to find some relationship by alleging that the President of Riverview Nursing Home was a general partner of the limited partnership that owns another nursing home (Mount Saint Francis). Even if that allegation were correct, it would not create an identity of interest between Riverview and Suburban. At most, it would create an identity of interest between Riverview and Mount Saint Francis, which has no relevance to Suburban.

Further, the existence of an identity of interest between Riverview and Mount Saint Francis is problematical. Assuming Riverview Nursing Home Incorporated to be the owner of the Riverview project, the Riverview President would have to be one of the following for Mount Saint Francis in order for those two projects to be in an identity of interest relationship:

- (a) an owner, general partner, officer or director, or
- (b) a person who directly or indirectly controls 10 percent or more of the voting rights or owns 10 percent or more of the owner entity.

The Riverview President is not a general partner of the limited partnership (Mount Saint Francis Associates), but is a general partner of a second limited partnership (Health Facilities Associates) which has a limited partnership interest in Mount Saint Francis Associates, the Mortgagor partnership. If the general partner (the Riverview President) of Health Facilities Associates (which has a limited partnership interest in Mount Saint Francis Associates) has an interest in the Health Facilities partnership such that he controls 10 percent or more of its voting rights or owns 10 percent or more of it, the threshold for identity of interest between Riverview and Mount Saint Francis is not reached. First, he would not directly or indirectly control 10 percent of the voting rights of Mount Saint Francis Associates, since the limited partnership agreement for that entity

¹ See "Certificate of Amendment to Certificate of Agreement of Limited Partnership of Edmund Place Associates," filed with the State of Rhode Island on May 25, 1990. (This document is one of the filings of this partnership and is included in Exhibit 3, which consists of all such filings with the State of Rhode Island.)

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Comment 12

places all control in the general partner and, in essence, gives the limited partner (Health Facilities Associates) no voting rights.² Second, the Riverview President would not own 10 percent or more of the "owner entity"; instead, he has an interest in a partnership which "owns" an interest in the owner entity. Thus, there is no basis for asserting that Riverview is an identity-of-interest entity with Mount Saint Francis.

The Draft Report's description of the ownership status of Hillcrest Village, Appendix C at p. 25, is also incorrect. The EVP is a general partner in Hillcrest Village Associates II, LP, which purchased this project from Hillcrest Village Associates (in which the EVP had no ownership). Hillcrest Village Associates II, LP continues to operate this project which has not been placed in receivership. Bowes Aff. at ¶ 4. Whether Hillcrest Village Associates (the original owner) has been placed in receivership is not known to Suburban and in any event, is not relevant. Finally, Suburban sold its rights in the Hillcrest Village loan in 1995, Richards Aff. at ¶ 10, so that this is no longer an identity-of-interest loan. Thus, the Draft Report should be corrected to show three identity-of-interest loans and one former identity-of-interest loan and to delete Edmund Place and Riverview from the listing of identity-of-interest loans.

Executive Vice President Approves Loans to Related Entities.

Comment 13

The assertion that the EVP "approved" three loans apparently stems from his participation in Board of Directors actions ratifying those loans. This assertion is incorrect. First, FHA-insured loans are "approved" by HUD, not by the mortgagee. Second, the President of Suburban made the final decision as to whether to seek HUD approval for a given loan application and to make that loan, contingent upon HUD approval and agreement to insure. While the EVP had input on these decisions, these decisions were made by the President. Any input by the EVP would have been treated no differently than the input of a representative of any other borrower. Further, the President's decision on whether or not to make the loan was an easy one: if HUD agreed to insure the loan, the President would have made it. Richards Aff. at ¶ 12.

As a member of the Board of Directors of Suburban, the EVP voted to ratify these three loans. The Hillcrest Village loan was ratified by the Board on December 14, 1992, some six months after the closing on that loan. The Edmund Place and Coventry loans were ratified on August 15, 1994, almost eight months³ and three months, respectively, after those loans closed. These facts make it clear that the EVP was merely performing a ministerial act and that his votes to ratify these loans

² See Section 7.01 of Exhibit 4, "Mount Saint Francis Associates Second Amended and Restated Agreement and Certificate of Limited Partnership," dated December 28, 1984.

³ The Edmund Place loan went to initial endorsement on December 22, 1993, had a mortgage increase in the amount of \$546,800 and went to final endorsement on June 29, 1995. Thus, the date set forth in the chart on p. 8 of the Draft Report has apparently confused the date of final endorsement with the date the loan initially closed.



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Comment 14

was certainly not the EVP "approving" them, especially given the fact that the loans had already been made. Richards Aff. at ¶ 13.

Contrary to the statement in this section, the EVP had no ownership interest in Edmund Place. See the foregoing discussion. This is another basis for concluding that the Draft Report's censure on this point is wrong. Thus, the concluding sentence of this section is wrong on both sides of its "equation." The EVP did not approve these loans and there is no such thing in the circumstances as a "proper arm's length transaction." Instead, there are permissible and impermissible identity-of-interest transactions. The ones in question were clearly permissible identity-of-interest transactions and were approved by HUD as such.

**Executive Vice President Paid to Originate Loans –
possibly to entities that Executive Vice President Owned.**

The Draft Report states that:

HUD regulations prohibit payments by lenders such as Suburban Mortgage to persons associated with or receiving compensation from the owner.

P. 8. This misstates 24 C.F.R. § 202.5(f), which is more correctly set forth at Appendix B, p. 21:

A mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction or transactions to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgage property... The mortgagee shall not pay a referral fee to any person or organization.

Comment 15

This language makes it clear that a payment by the mortgagee (Suburban) is not prohibited unless the recipient "has received" other consideration. In other words, the recipient of a payment from the mortgagee must have already received other consideration for this prohibition to be triggered.

The Draft Report does not allege that the EVP had already received fees from two properties in his role with the ownership entity since that did not occur. Any payments received by the EVP were received only after the property started operations and were compensation for his management of the property. See the financial reports for these two properties. Nor had the EVP received consideration from the "sale of the mortgaged property" since there is not even an allegation that he was the owner of the mortgaged property. Similarly, monies paid to the EVP by Suburban were consultant's fees which were paid in accordance with the consulting agreement between him and Suburban. Thus, there is no violation of 24 C.F.R. § 202.5(f).



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In addition, it should be noted that the statement that the EVP "owns five properties to which Suburban Mortgage provided HUD-insured loans." As shown above, he never had any ownership interest in one of the insured properties.

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Also, the audit report notes that Suburban paid the EVP more than \$65,000 per year "for loan origination services." These payments were actually made for consulting services. Nor are such payments typically paid as employees' salaries. Consultant services are paid with consultant fees, and even if this was for loan origination services, there is no established industry practice that only employees participate in Traditional Application Procedures origination and processing. The use of consultants is acceptable for such purposes.

Misleading Assertions by Suburban Mortgage Regarding Selected Loan Recipients.

The Draft Report persists in insisting that six loans, not four as was actually the case, were made to "related" entities. As has been shown above, the proper standard is identity-of-interest entities, and identity-of-interest arrangements are permissible if disclosed and not otherwise prohibited.

The thrust of this allegation is that Suburban and the mortgagors "provide HUD misleading, confusing, and conflicting information" regarding the nature of the identity-of-interest relationships. The two loans cited appear to be for Mount Saint Francis and Hillside Health Center. *See* Appendix C at pp. 26-27.

For the Mount Saint Francis loan, the assertions are (1) that the EVP signed a declaration stating that there was no identity-of-interest; (2) that Suburban certified that it had no interest in the owner of Mount Saint Francis and that the owner of Mount Saint Francis had no interest in it; and (3) that the EVP and the President of Suburban signed the same documents representing different entities.

The EVP's declaration was made in response to a letter from HUD, dated August 12, 1994 which identified a number of deficiencies in the firm commitment application for Mount Saint Francis. Among the actions required to correct these deficiencies was:

17. Certification identifying any Identity-of-Interest Relationships between the Mortgagor, General Contractor, and/or Architect is required, as well as one for the present mortgagee.

In response, the EVP certified:

I hereby certify that there is no identity-of-interest to any of the parties involved in this proposal, i.e., contractor, architect, mortgagee.

Thus, the EVP was responding to an inquiry concerning the "present mortgagee" which would be the mortgagee at the time of the letter (August 12, 1994). The mortgagee at that time was the Rhode Island Housing and Mortgage Finance Corporation, and Suburban did not become the mortgagee

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until 1995, when the project was refinanced with a new loan. Richards Aff. at ¶ 14. Thus, the EVP's declaration is not wrong or misleading. It correctly responds to the question asked by HUD.

Second, Suburban's May 1995 certification was correct. Suburban had no interest in the partnership which owned Mount Saint Francis and that partnership had no interest in Suburban. There was an identity-of-interest between the two since one individual was the EVP of Suburban and the general partner of the partnership, but no holding of an interest in one entity by the other. To certify other than as Suburban did would be to misrepresent the facts, which is apparently what the Draft Report would have had Suburban do.

Similarly, there is no prohibition on the EVP and the President signing the same documents on behalf of different entities as long as it was clear who was signing for what entity. The Draft Report does not purport to allege misrepresentation as to who was signing for what, presumably since there was none. It is not uncommon, both as a matter of general practice and of HUD closings, for a single individual to sign the same document in different capacities so long as his or her capacity for each signature is clearly identified.

The Draft Report goes on to complain that "outside observers could not identify the relationships between the parties." With all due respect, the only thing that is relevant is that HUD knew those relationships. HUD approved these relationships, and these relationships were already well known to HUD's Providence office.

Appendix C at p. 27 correctly notes that the Mortgagee Certificate for the Hillside Health Center loan contained a rider stating that the EVP had an interest in Hillside and an interest in Suburban, adding that the transaction was an arm's length transaction and that neither Suburban nor Hillside had a controlling interest in the other. The Draft Report then complains that the statement in the rider is misleading since it did not identify that the EVP "owns 50 percent of Suburban Mortgage."

What is misleading is the allegation in Appendix C because it asserts that a failure to specify that the EVP owned 50 percent of Suburban violates HUD regulations or guidance. HUD's identity-of-interest provisions require the disclosure of an identity-of-interest if there is a 10 percent or more ownership interest. See the definition in Appendix B. Those provisions do not require further disclosure of the percentage of ownership. Thus, the statement in the rider complies with HUD requirements.

Finally, Appendix C complains that "Interest between related entities need not be controlling to demonstrate significant influence." The significance of this assertion is uncertain since HUD's identity-of-interest provisions recognize this possibility and therefore require the disclosure of identity-of-interest relationships. Since this disclosure was made in Hillside, this assertion is meaningless.

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Thus, there is no misleading, confusing, or conflicting information involved since appropriate disclosures were made. It may be that the Draft Report's objection to the language in the rider results from its challenge to the statement that these were arm's length transactions. As has been shown above, the term "arm's length transaction" has no meaning in a Section 232 insured loan transaction, and the President of Suburban has explained why he believed (and believes) this to have been an arm's length transaction. Richards Aff. at ¶ 15. Therefore, this assertion, as well as the other assertions in this section of the Draft Report, are without foundation.

Suburban Did Not Identify Improper Distributions to Owners.

This section of the Draft Report begins by boldly asserting that:

Suburban Mortgage did not identify improper cash distributions to the related entities of two properties that received HUD-insured loans.

Unfortunately for the truth, this assertion ignores the facts, relevant HUD guidance, and the way that FHA-insured projects work. The force of this assumption also derives from the wholly improper assumption that identity-of-interest payments equal "improper cash distributions." In order to understand the fallacy of this assertion, it is necessary to examine the actual situation.

First, cash distributions by a mortgagor or operator of a nursing home are controlled by the respective Regulatory Agreement between the mortgagor or lessee and HUD. This means that HUD has a contractual relationship with the mortgagor or lessee and is therefore the entity to take action against any improper payments by a mortgagor or lessor. HUD is quite jealous of its responsibility and warns mortgagees not to become involved in violations of the Regulatory Agreement by stating:

...the Regulatory Agreement is an agreement between a mortgagor and HUD and HUD considers enforcement of its provisions to be a matter between mortgagors and HUD itself.

HUD Handbook 4350.1, ¶ 1-10. Nothing could be more clear: improper distributions by a mortgagor or lessee is HUD's responsibility. Concern about improper payments is one of the reasons that HUD requires mortgagors to submit monthly reports to HUD -- not to the mortgagee. Therefore, if OIG believes that there are such improper payments, it should examine why HUD officials approved those payments, failed to identify their impropriety, and did not take corrective action.

Second, it is necessary to understand the structures under which these two properties operated. Coventry was operated by a lessee of the mortgagor, which lessee had entered into a separate Regulatory Agreement with HUD. Suburban was not in privity of contract with this lessee, and as the above quoted guidance makes clear, regulating it was HUD's sole responsibility. The payments

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referenced in the Draft Report were made by the lessee for management services and were approved by HUD when it approved the "Owner's and Management Agent's Certification for Multifamily Projects for Identity-of-Interest or Independent Management Agents." Further, HUD received monthly reports from which it could divine what payments were being made. Suburban, as mortgagee, did not normally receive such reports. Thus, the responsibility for suspect payments, if any, falls solely on the shoulders of HUD, and the Draft Report should not attempt to whitewash HUD's failures (if there were any) by blaming Suburban.

The mortgagor of Mount Saint Francis operated that facility without a lessee. In this circumstance also, Handbook 4350.1, ¶ 1-10 makes it clear that regulating the mortgagor was HUD's responsibility. The Mount Saint Francis payments to the EVP complained of were general partner's management fees; these fees and the amounts of these fees were approved by HUD through the HUD Certification form described above. Again, monthly reports were provided to HUD. Thus, it is wholly improper for the Draft Report to attempt to impose on Suburban the burden that HUD guidance places firmly on the shoulders of the Department.

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Management fees are operating expenses, which the Draft Report acknowledges can appropriately be paid by a mortgagor or lessee. Thus, its references to surplus cash are wholly irrelevant. Further, the Draft Report's assertion that the EVP had not provided goods or services for these payments is totally unsupported by any facts cited. In the first instance, there is substantial question as to how OIG could ascertain any facts which would permit it to draw such a conclusion. Second, this also raises the question of why HUD would approve such payments.

It follows from the foregoing that the allegations that Suburban did not detect these payments, question the mortgagors about them, or review them adequately are completely false. This was HUD's responsibility and HUD's alone. Indeed, even if Suburban had been in a position to identify these payments, it did not have any ability to remedy them since it had no rights under the relevant Regulatory Agreements, which were between the mortgagor (or the lessee) and HUD.

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This section of the Draft Report goes on to assert that "Suburban has a disincentive to provide HUD with accurate and complete information..." That assertion is palpably and demonstratively false. The great fear of any mortgagee is that a loan will go into default and either be assigned to HUD or foreclosed. In either event, the mortgagee will almost inevitably be harmed financially, and the result of a mortgagee not providing HUD with information so that HUD can take appropriate corrective action when substantial improper payments are made is likely to be default and assignment or foreclosure.

The impact on a mortgagee, such as Suburban, in the event of a default which leads to assignment or foreclosure, is easy to understand. A mortgage loan such as the ones at issue here are insured for 99 percent of the outstanding balance by HUD, with the mortgagee retaining 1 percent of the risk. In addition, HUD does not reimburse the mortgagee for one month's interest. The 1 percent of principal and one month's interest for Hillside, for example, alone totals \$194,041.88. In addition,



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HUD will only reimburse a mortgagee for interest paid at the "debenture" rate, not at the rate on the note. Since the debenture rate is lower than the note rate, this results in another shortfall for the mortgagee. Finally, HUD may "curtail" (not pay) interest at the debenture rate in the event that certain regulatory requirements are not met in a timely manner. Reduction of its insurance claims by these amounts will have a substantial financial impact on Suburban. Richard Aff. at ¶¶ 16. Knowledge of these potential significant adverse financial impacts is a strong incentive, not a disincentive, for a mortgagee to report any suspect payments by the mortgagor or lessee (assuming it has knowledge of such payments) to HUD.

This section of the Draft Report makes two additional assertions. First, it states that the EVP, his companies, and/or one or more of his children received payments from the properties they owned or were affiliated with. Again, this allegation has fallen into the trap of equating identity-of-interest payments with impropriety. It offers no evidence of any impropriety.

Second, it alleges that the EVP benefits from the profits received by Suburban on account of \$19 million in mortgage interest that it received on these loans. Sadly, this shows a virtually complete ignorance of mortgage banking in the FHA insurance context. Almost no mortgage banker retains the FHA-insured loan and thus benefits from the interest thereon and the profits generated thereby. Instead, FHA-insured loans are sold, either as whole loans, as GNMA mortgage backed securities, or in similar ways. In any event, the interest on these loans is "passed through" to the ultimate investor, with the mortgagee retaining only a very small fee for servicing the loan. This fee is, to state the obvious, for servicing the loan, which involves a variety of functions, all of which have a cost. Thus, a mortgagee derives servicing income from mortgage interest but only on such loans as it services, and any profit generated from this business activity is an infinitesimal fraction of the mortgage interest itself.

The foregoing analysis shows that this section of the Draft Report is wholly misconceived and demonstrates a complete lack of even the most basic understanding of FHA mortgage insurance programs. There is no evidence that the cash payments were "improper cash distributions"; there is no evidence that these cash payments were improper or that the EVP had not provided goods or services for them; HUD's unequivocal position as to Suburban's responsibility for detecting any suspect payments is that it is HUD's responsibility and HUD's alone; it is foolish to talk of Suburban Mortgage having a disincentive to provide HUD with accurate and complete information; and the \$19 million in mortgage interest is a chimera.

Failure to Notify HUD of Delinquent Mortgage and Reserves Payments.

In this section and the next, the Draft Report finds that Suburban violated its servicing obligations. This discovery was relatively easy since Suburban acknowledged its mistake as soon as it discovered it. Even so, the Draft Report "spins" the facts, asserting that Suburban "claimed" that HUD allowed the deferments in question instead of acknowledging the actual facts, that Suburban believed that it had obtained such approval from HUD. Richards Aff. at ¶ 19.

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Again, some background in loan servicing procedures and the facts of this case is useful in understanding this situation. Amortization of the mortgage loan principal and deposits to the reserve for replacement for the Hillside loan were scheduled to begin August 1, 1999. While the mortgagor was able to make the interest payments on the mortgage note, problems with filling the nursing home beds and the ensuing financial crisis caused it to not make property tax payments, unamortized payments of the loan principal, and payments to the reserve for replacement escrow. Through an administrative oversight,⁴ Suburban failed to obtain HUD's prior approval before implementing HUD prescribed procedures to avoid a default. However, when Suburban learned that the mortgagor's financial difficulties would preclude it from making these payments, Suburban followed HUD prescribed guidance in an effort to avoid a default and an ensuing claim for mortgage insurance. Richards Aff. at ¶¶ 17-20.

HUD guidance provides that a mortgagee may request HUD approval to suspend payments to the reserve for replacement and for amortization until final endorsement in order to assist troubled mortgagor to reinstate a defaulted loan and go to final endorsement. HUD Handbook 4350.4 CHG-7, ¶ 2-42. The required HUD approval for implementing these procedures was not obtained simply because, as noted above, Suburban believed that it had already obtained such approval.

Suburban concluded that these workout tools would provide the necessary relief to the mortgagor and were the only available means by which this loan could be saved from default and assignment to FHA, which would result in a claim on the mortgage insurance fund. Suburban also negotiated an arrangement with the investor which had purchased the GNMA guaranteed security that is backed by the FHA mortgage on Hillside in order to give the mortgagor more time to resolve its financial problems. Richards Aff. at ¶¶ 22-23.

On or about January 2003, Suburban realized that it had not received the necessary HUD approvals for the actions it had undertaken and promptly notified HUD of this failure. On March 17, 2003, the mortgagor submitted a plan to HUD to pay delinquent reserve for replacement deposits. Pursuant to this plan, the mortgagor began paying the amortization and deposits currently required and agreed to pay the unfunded amount on a set schedule, beginning at final endorsement. In an April 11, 2003 letter, HUD approved the mortgagor's plan concerning the reserve for replacement account. HUD also orally approved payment of the unamortized principal at final endorsement. Richards Aff. at ¶¶ 24-27.

Through the efforts of the mortgagor, with assistance from Suburban, the project was turned around financially, so that by December 2003, it was at sustaining occupancy. By the end of that

⁴ As has previously been explained to OIG, this administrative oversight resulted from a misunderstanding among Suburban personnel.

Note that, at the same time, Suburban was providing notices of default to HUD for Coventry. These actions emphasize that Suburban's failure to notify HUD resulted from a mistake.



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month, all defaults had been resolved or were subject to being resolved under agreed plans. On January 21, 2004, HUD denied Suburban's January 12, 2004 request to proceed to final endorsement. Richards Aff. at ¶¶ 28-29.

For reasons unrelated to its past troubles, the Mortgagor could not make the March 1, 2004 loan payment and Suburban timely notified HUD of the default. Suburban notified HUD of its Election to Assign the mortgage on May 12, 2004. Richards at Aff. at ¶¶ 30-31.

The foregoing facts show that Suburban, through inadvertence, failed to notify HUD of these defaults by the mortgagor and failed to obtain HUD approval for implementing HUD prescribed workout procedures. Suburban has admitted this mistake from the moment that it discovered its failure to notify. This may be a basis for curtailing the debenture interest paid to Suburban under 24 C.F.R. § 207.259(b)(1)(iii), but it is not a basis for the sweeping conclusions and recommendations advanced by the Draft Report.

Suburban Did Not Assure Payment of Real Estate Taxes.

Again, Suburban has acknowledged its failure to notify HUD that Hillside had failed to make the required payments into the real estate tax escrow. The reason for this was quite simple. Notwithstanding language in the Mortgage Deed, the general industry practice is to begin collecting for real estate taxes from the mortgagor and placing these collections in the tax escrow when the loan begins to amortize. Richards Aff. at ¶ 32. Since Suburban was operating under the admittedly mistaken belief that a deferral of amortization of principal had been authorized by HUD, paying the amortization had not begun and logically the tax escrow was not established.

The Draft Report is incorrect when it states that Suburban did not take action to ensure that Hillside paid these taxes. When it received notice of the tax delinquency, it required Hillside promptly to enter into payment plans with the City of Providence. Suburban did not notify HUD of these payment plans because it was advised by Rhode Island title counsel that the existence of a payment plan agreement meant that if Hillside was in compliance with the agreement, the relevant taxes were not yet payable and therefore not delinquent. Richards Aff. at ¶ 33. No notification to HUD is required in such circumstances.

Thus, Suburban's admitted failure to notify HUD about taxes is part of the failure described in the preceding section. However, partly as a result of Suburban's actions, all back taxes were paid by December 2003. Richards Aff. at ¶ 28.

Prudent Industry Practice.

In this section, the Draft Report concludes, based on the responses of mortgage bankers, that Suburban did not follow prudent industry practices and that HUD should not have insured the loans. It is impossible to comment fully on this since HUD does not identify these "members of the mortgage banking industry," so that a commenter cannot ascertain whether these individuals know

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what they are talking about. Further, it does not identify the prudent industry practices that Suburban allegedly failed to follow. As a consequence, Suburban cannot ascertain whether OIG's presumed prudent industry practices are indeed prudent industry practices.

More important, the Draft Report does not set forth what "facts" OIG used in describing these relationships and how those "facts" were characterized. Indeed, if the factual inaccuracies in the Draft Report that have been identified in these comments is any indication, the facts on which these mortgage bankers relied bore no resemblance to reality. Thus, these vague and conclusory statements should be ignored.

The same holds true for the similar comments attributed to the State of Maryland - the Office of the Commissioner of Financial Regulation. Again, the respondent in that Office is not identified so that it is impossible to determine whether that person knows what he or she is talking about. Further, the "facts" presented to that Office are subject to the same objections as the "facts" presented to the mortgage bankers.

Since the Draft Report does not define "prudent industry practice," we presume that it used the same definition as utilized by the FHA-insured industry: a mortgagee shall comply with HUD requirements in the processing and servicing of loans. With respect to loan processing, the foregoing comments have conclusively disposed of allegations in the Draft Report to the effect that Suburban somehow violated HUD processing requirements.

Similarly, with a single exception, Suburban has complied with HUD's servicing requirements. These are succinctly stated in HUD Handbook 4350.1 REV-1, ¶ 1-10: "mortgagees are chiefly responsible for obtaining compliance with the covenants of [the Mortgage and the Note]. 'Such compliance cannot be guaranteed; if it could, there would never be a default, and FHA mortgage insurance would be unnecessary. Suburban has followed, at a minimum, standard industry practices in an effort to obtain mortgagors' compliance with Mortgage and Note covenants.

Suburban's compliance with prudent industry practices is not affected by its reaction (or failure to react) to alleged Regulatory Agreement violations. Clearly, HUD has claimed exclusive jurisdiction over such violations. It requires nothing of mortgagees with respect to such violations and only "encourages mortgagees to inform HUD when mortgages become aware of Regulatory Agreement infractions and to work with HUD and mortgagors to correct these Regulatory Agreement violations. [emphasis added]" HUD Handbook 4350.1 REV-1, ¶ 1-10.

The one exception was Suburban's failure to notify HUD of the Hillside Mortgagor's payment default. Without minimizing this failure, it must be recognized that Suburban adopted HUD-prescribed work out procedures and worked with the Mortgagor to resolve its problems. As a result, the value of the mortgage security was not adversely affected, which is the objective of following prudent industry practices.

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There is one important point to be gleaned from this section, however. Even under the worst possible description and characterization of the facts (i.e. the likely mischaracterization of the facts by OIG), these mortgage bankers concluded that "the situations described were not explicitly prohibited by HUD's regulations and guidelines..." Suburban submits that this should be the end of the matter. If Suburban is in compliance with HUD's regulations and guidance, it should not be hounded by OIG simply because OIG personnel believe that identity of interest relationships and identity of interest payments in the context of FHA-insured loans are inappropriate. *See Patriot, Inc., 963 F. Supp. 1*. Rather, the proper course for OIG would be to take up its concerns with the Office of Housing and the Office of General Counsel so that the regulations and guidance can be changed in a manner that OIG believes is more appropriate.

Suburban Mortgage's Failures Lost HUD \$14 Million.

Once again, this section is bedeviled by factual inaccuracies. As noted above, two of the four mortgages that Suburban made to identity-of-interest entities defaulted on their HUD-insured loans and HUD paid on one loan. HUD's loss on identity of interest loans was \$6,292,520 (see Draft Report at p. 14), not \$14,003,674.

The Draft Report then asserts that Suburban failed to act in a proper fiduciary capacity and thereby protect HUD from unacceptable risk of default for Edmund Place. It adds that HUD should pursue Suburban for the recovery of these losses.

These assertions ignore the facts and rely solely on the conclusory statements of the OIG. There is no evidence that Suburban failed to act in a proper fiduciary capacity, especially since Edmund Place was not an identity-of-interest situation, which OIG incorrectly presumes. A mortgagee's fiduciary obligations to HUD are not limitless. Those obligations are to obtain compliance with the covenants of the Mortgage and the Note. HUD Handbook 4350.1 REV-1, ¶ 1-10. Hence, Suburban fully fulfilled its fiduciary obligations with respect to Edmund Place.

Further, there is no basis given for the assertion that HUD was exposed to unacceptable risks of default for Edmund Place. Presumably, OIG believes this to be the case because of its incorrect belief that identity of interest loans are improper -- a belief that is irrelevant to this non-identity of interest loan.

Finally, suggesting that HUD should pursue Suburban for the recovery of these losses ignores the National Housing Act under which these loans were insured. Section 203(e) provides that:

Any contract of insurance heretofore or hereafter executed by the Secretary under this title shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and the validity of any contract of insurance so executed shall be incontestable in the hands of an approved financial institution or approved mortgagee from the date

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of the execution of such contract, except for fraud or misrepresentation on the part of such approved financial institution or approved mortgagee.

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Thus, failure to act in a proper fiduciary capacity and/or failure to protect HUD from unacceptable risk of default, even if those allegations were true, would not be a basis for pursuing Suburban for recovery of these losses. Only fraud and misrepresentation are grounds for contesting the mortgage insurance, and neither of these allegations constitutes either fraud or misrepresentation.⁵ While it appears that OIG believes a different standard is appropriate for voiding FHA insurance, Congress has spoken clearly on this point. Therefore, OIG's recommendation is simply an effort to defy the statute and to substitute its beliefs for Congress' judgment.

The Draft Report next asserts that HUD is at risk of incurring additional losses from defaults on the remaining three loans to related entities totaling \$25.8 million. HUD has risk on all insured loans, which is why it provides insurance. Nor does the assertion that there is increased risk for identity-of-interest loans carry any weight since such loans are permitted by HUD and should not be retroactively condemned. Further, there are factual inaccuracies in that Riverview Nursing Home is not an identity-of-interest entity, and Suburban has long since sold the servicing responsibility for the Hillcrest Village loan. With respect to Hillcrest Village, Section 203(e) limits the fraud or misrepresentation which can void the insurance to that by the noteholder. Suburban is no longer the noteholder and OIG has not identified the current noteholder or alleged any misconduct on its part. There is certainly no basis for HUD action on any of these three loans.

The Draft Report does not even attempt to allege fraud and misrepresentation, because there is none, so that there is no basis for the conclusion that HUD should terminate the loan insurance. And since "...the situations described were not explicitly prohibited by HUD's regulation and guidelines..." (Draft Report, p. 12), there is no basis for the conclusion that HUD should withdraw Suburban's approval to participate in its mortgage insurance programs.

Referral to the Mortgage Review Board.

Suburban acknowledges that HUD notified Suburban of alleged violations in a letter dated January 30, 2003, but has no knowledge pertaining to internal action by HUD concerning a referral to the Mortgage Review Board. Suburban also acknowledges that when it notified HUD concerning the

⁵ This language has been adjudicated, and the courts have spoken clearly. In the definitive case on this language, *Jay F. Zook Inc. v. Brownstein*, 237 F. Supp. 800 (N.D. Ohio 1965), the court held that the purpose of the incontestability provision in the federal mortgage insurance statute was to make the law of estoppel applicable to the government where the validity of a F.H.A. insurance contract was challenged.



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payment plans for real estate taxes for 2000, 2001 and 2002, it did not address 1999 taxes because 1999 taxes had already been paid.

Conclusion

The foregoing analysis establishes that this conclusion consists wholly of inaccurate assertions and of conclusions that can be justified only by misunderstanding the facts, ignoring the law, and pretending that relevant HUD guidance does not exist. The principal conclusion is that Suburban did not "carry out all of its fiduciary responsibilities." This conclusion can be supported only by the misstatements set forth in the subsidiary conclusions. By contrast, more accurate subsidiary conclusions are as follows:

- Suburban did not provide misleading, confusing and conflicting information to HUD for four identity-of-interest properties in which the EVP of Suburban had an interest.
- Suburban disclosed all identity of interest relationships and satisfied all applicable disclosure requirements.
- HUD's Providence office had a complete and thorough understanding of the identity-of-interest relationships involved with these four properties. Further, HUD approved these relationships, authorized Suburban to make these loans, and approved the payments made when it approved the HUD Certification form for identity-of-interest management agents/nursing home operators.
- Since HUD had proper information regarding identity-of-interest relationships, and since it had approved these relationships, HUD has no basis for taking corrective action concerning identity-of-interest.
- Although Suburban's failure to provide timely notification of default prevented HUD from taking corrective remedial actions, there is no basis for concluding that HUD would have taken remedial action different or more successful than the action taken by Suburban. Further, Suburban's efforts helped restore the project in question to a position of financial health so that the mortgage could have gone to final endorsement.
- The "failures" attributed to Suburban with respect to the \$14 million and the \$25.8 million figures cited were not failures. There is no evidence that the \$25.8 million cited has any increased risk, whether necessary or unnecessary.

As can be seen from the foregoing, it is readily apparent that Suburban properly discharged its fiduciary duties.

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Recommendations

The Draft Report advances four recommendations. Each is discussed in turn.

- 1.A. Pursue recovery of the \$7, 711,154 from Suburban Mortgage and the owners of Edmund Place Health Center.

This proposed recommendation stems from misunderstanding the facts and ignoring applicable law and HUD guidance and practice. It is based on the incorrect assumption that identity-of-interest loans are inappropriate, misapprehends the fact that Edmund Place did not involve an identity-of-interest transaction, and ignores the statutory mandate that insurance claims cannot be denied except for fraud or misrepresentation. There is absolutely no basis for this recommendation.

- 1.B. Require Suburban Mortgage and the owners of the Hillside Health Center to reimburse \$229,673 for the interest charges incurred from the late payment of the real estate taxes.

Once HUD accepts the Hillside Health claim for insurance benefits, Suburban will pay for any interest or penalties that may have accrued on real estate taxes in order to meet HUD multifamily claim regulations. HUD Form 2741, *Instructions for Application for Insurance Benefits*, confirms that taxes that become delinquent with 45 days from the recording of the assignment to HUD must be paid by the mortgagee. (HUD receives independent evidence of payment of taxes from the endorsed title policy delivered to HUD.) Under 24 C.F.R. 207.259(b)(1)(i), HUD reimburses an assigning mortgagee for taxes advanced by a mortgagee – but not any interest or penalties that may have accrued on such taxes. HUD 2741 details that any interest or penalties on taxes that are paid by the mortgagee to meet HUD claim requirements are not reimbursed by HUD in the multifamily settlement, but may be included in the Certificate of Claim for such claim. Of significance, the HUD 2741 reflects that interest or penalties on real property taxes are not a matter of special investigation for HUD's IG, but a servicing error that occurs quite regularly for FHA multifamily servicers.

Without accepting the claim for insurance benefits for Hillside Health, this second recommendation is nonsensical. Assuming that HUD never pays insurance benefits, the recommendation requires Suburban to "reimburse" HUD for payments that HUD never made and that HUD will never be at risk to make. This recommendation, like the others in the Report, disregards well-established HUD regulations that control claims for insurance benefits.

- 1.C. Terminate the insurance for the three remaining loans to identity-of-interest related properties -- Hillcrest Village, Mount Saint Francis Health Center, and Riverview Nursing Home -- estimated to be \$25,438,400.

Again, this recommendation ignores the statute and presumes that identity-of-interest transactions are prohibited. Such transactions are not prohibited, so this recommendation is totally without

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foundation. Indeed, if identity-of-interest loan transactions were not permitted, OIG should be concerned about HUD staff who underwrote these loans and approved them, knowing full well that they were identity-of-interest loans.

This recommendation also suffers from being factually challenged. Riverview is still not an identity-of-interest entity, and Suburban long ago sold the servicing responsibility for the Hillcrest Village loan.

- 1.D. Take appropriate administrative sanctions against Suburban Mortgage and its principals for its failure to perform its mortgage-related fiduciary duties.

There is simply no basis for this allegation since the Draft Report provides no evidence of a failure to perform fiduciary duties. The primary bases relied upon in the report for such an unsupported allegation are the presumptions that identity-of-interest loans are improper and that payments to identity-of-interest entities constitute "improper cash distributions." The only support for either presumption is the numerous other places in the report in which these presumptions are advanced. Perhaps OIG believes that if statements are repeated a sufficient number of times, they will become true. Unfortunately for the accuracy of the Draft Report, that is not the case.

One additional factor deserves mention. The footnote to this section notes that OIG will recommend that HUD pursue recovery of \$8,935,730 for Coventry. Laying aside the correctness of the dollar amount, it is clear that OIG has made up its mind about Coventry, without waiting for any comments from Suburban. Unfortunately, that typifies OIG's approach to this entire review. It appears to have developed its conclusions and recommendations and then proceeded to conduct this review. When the results of the review did not support these already developed conclusions and recommendations, the Draft Report misstates the facts, ignores the law and applicable guidance, and presumes the impropriety of identity-of-interest transactions. Those actions completely vitiate the validity of the Draft Report's conclusions and recommendations. Since the report is utterly flawed and lacks any basis (except for the previously admitted failure to notify), it should be withdrawn.

Several additional comments on already discussed or peripheral matters are set forth in the attachment to this letter. If there are any questions concerning these comments or the attachment, please contact the undersigned at (202) 457-6074.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy A. Vanderver, Jr." followed by a stylized flourish.

Timothy A. Vanderver, Jr.

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June 28, 2005

Timothy A. Vanderver, Jr.
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tvanderver@pattonbogggs.com

Ms. Cristine M. O'Rourke
Assistant Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
10 Causeway Street, Room 370
Boston, Massachusetts 02222-1094

Re: Audit Report No. 2005-BO-100X

Dear Ms. O'Rourke:

This letter forwards copies of certain documents that you requested at the exit conference on June 22, 2005 on the above-referenced draft report between representatives of HUD's Office of Inspector General and representatives of Suburban Mortgage Associates Incorporated. In addition, it provides certain information relative to these requests.

Before addressing these responses, please note an error in Suburban's June 6, 2005 comments on OIG's draft report. In the first paragraph of page 5, there is a sentence that reads "The Edmund Place loan did not go to final endorsement until December 1993..." Instead of referring to "final endorsement," that sentence should have noted that "The Edmund Place loan did not go to initial endorsement until December 1993..." We apologize for this error.

The responses to your requests for documents and questions are as follows:

1. Suburban has not been able to locate a copy of Mr. Antonio L. Giordano's resignation letter. However, it has located minutes of the meeting in which Suburban's Board of Directors acknowledged and accepted Mr. Giordano's resignations on November 13, 2003 and minutes of the meeting when it elected Edward L. Maggiacomo to the Board. Copies of those minutes are enclosed.
2. Enclosed please find a copy of the Purchase and Sale Agreement between Suburban and GMAC which included the sale of the Hillcrest Village loan. This Agreement is dated as of May 31, 1995. The last three pages of Exhibit A, which pages have been tagged for your convenience, list the information pertaining to Hillcrest Village.

Washington DC | Northern Virginia | Dallas | Denver | Anchorage | Doha, Qatar



Ms. Cristine M. O'Rourke
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Page 2

3. You also requested copies of Suburban's Line of Credit Agreement with Residential Funding Corporation. The pre-1996 agreements were destroyed several years ago. Enclosed are copies of the agreements from 1996 until the present. For the 2002 Agreement, Suburban was not able to locate the Promissory Note or the Guaranty that was signed by Mr. J. Walsh Richards, Jr. and Mr. Giordano. Also, the RFC warehouse department was sold to Washington Mutual Bank on March 4, 2005 so that Suburban's warehouse line of credit is now with Washington Mutual.
4. Enclosed is a copy of the loans that Suburban has assigned to HUD. Hillside is included as part of that list, with the notation that HUD has not accepted the assignment. The inclusion of Hillside in Suburban's list may account for the difference between Suburban reporting the assignment of thirteen loans, while you indicated that HUD's records indicated that twelve loans had been assigned.
5. You also inquired as to the date on which a firm commitment was issued for the Edmund Place loan. While that date is irrelevant to the question of whether the Edmund Place loan was an identity-of-interest loan, please be advised that Suburban submitted the application for a firm commitment for Edmund Place on May 6, 1993 and was issued a firm commitment on November 19, 1993. These dates are almost 4 and almost 4½ years after Mr. Giordano's withdrawal from the Edmund Place partnership.

I trust this is responsive to the requests for documents and inquiries that you and your colleagues made on June 22. If not, or if you have any further inquiries, please do not hesitate to contact me at (202) 457-6074.

Sincerely,

A handwritten signature in black ink, appearing to read 'Timothy A. Vanderver, Jr.'.

Timothy A. Vanderver, Jr.

cc: Ms. Jonelle Decator
Bryan P. Saddler, Esq.
William C. Lane, Esq.
(w/out encls.)

OIG Evaluation of Auditee Comments

Comment 1

Although the mortgage banker finds these situations were not specifically prohibited, the auditee's conclusion that that these situations provide no basis for questioning Suburban Mortgage is false. In 24 CFR 202.5 (j), Ineligibility, the regulations advise that neither the lender or mortgagee, nor any officer, partner, director, principal or employee of the lender or mortgagee shall be engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility. Therefore, Suburban Mortgage is required to comply with generally accepted practices of prudent mortgagees. By originating loans that were not arms-length transactions and creating conflicts of interest, Suburban Mortgage has violated this regulation. No changes were made to the report.

Comment 2

The report does not state that Suburban Mortgage should have pursued action outside of reporting the incident to HUD. We made wording changes and added HUD requirements to clarify the mortgagee's responsibilities.

Comment 3

The report does not state that identity-of-interest equates to improper cash distributions. We have adjusted the report for clarity.

Comment 4

The requirements cited within this report trace to a federal regulation or HUD handbook. No changes were made to the report.

Comment 5

As noted in footnote 12 on page 13, we do not take exception to the identity-of-interest relationships in the lending process where appropriately disclosed. OIG is aware of multifamily accelerated processing requirements and traditional application processing requirements and it is unclear as to what part of the report the auditee is referring. No changes were made to the report.

Comment 6

As stated in 24 CFR 202.5, mortgagees are required to act prudently. Our definition of arms length transactions is derived from Code of Ethics of the National Association of Mortgage Originators, Canon of Ethics for the Mortgage Bankers Associations, and the internet publication of Dictionary.Law.Com. We did not make changes to the report to include these references.

Comment 7

OIG began its review of Suburban Mortgage in August 2003 before Suburban Mortgage's assignment of Hillside Health Center. Our report is not an attempt to justify HUD's actions. No changes were made to the report.

Comment 8	Our original calculation of the number of defaults included mortgages that had been prepaid. We have adjusted the reported number of defaults.
Comment 9	During the audit period of January 1, 2001, to December 31, 2003, the executive vice president held the roles described in the bullets on page 6. We have adjusted the report to show that the second management agent and two of the service companies were owned by partnerships or corporations owned, in part, by one or more of executive vice president's children.
Comment 10	The executive vice president owned Edmund Place from 1981 to 1989. Sterling Health Care Management managed Edmund Place for its subsequent owners at the time of default. Sterling Health Care Management is owned by children of the executive vice president. We have adjusted the report to reflect this relationship.
Comment 11	Riverview Towers is affiliated with Mount Saint Francis Health Center--not an identity-of-interest entity with Suburban Mortgage. Riverview Towers is affiliated with the executive vice president of Suburban Mortgage because the general partner of Riverview Towers is a limited partner of the partnership that owns Mount Saint Francis Health Center. The executive vice president is the general partner of the limited partnership that owns Mount Saint Francis Health Center. We made wording changes to clarify.
Comment 12	We have adjusted the report to reflect that Hillcrest Village is not in receivership.
Comment 13	HUD approves the loan for Federal Housing Administration insurance, but the mortgagee must first agree to take the loan. The mortgagee also shares in the risk for each loan and the assumption of this risk requires approval by the mortgagee's board of directors. To allow a board member to ratify a loan where he has an identity-of-interest shows these loans were not proper arm's-length transactions. From the auditee's comments, it appears that Suburban Mortgage did not evaluate the loans for its own risk, which shows a total lack of responsibility in the lending process.
Comment 14	The executive vice president owned Edmund Place from 1981 to 1989, which is prior to the 1993 loan from Suburban Mortgage to the new owners of Edmund Place. We have adjusted the report to reflect this relationship.
Comment 15	We have edited the report to clarify how the staed regulation specifically applies to the situation noted.

Comment 16	See Comment 10.
Comment 17	The violation in the report is that the executive vice president cannot be paid on both sides of the transaction. Our report does not state only employees can originate loans. We adjusted our report to further clarify.
Comment 18	The executive vice president signed two separate documents. On September 28, 1994, the executive vice president signed one document stating that each principal sponsor had no relationship with the present mortgagee. On September 28, 1994, the executive vice president signed another document certifying that there was no identity-of-interest to any of the parties identified in the proposal. Where the first certification addresses the request for the relationship with the present mortgagee, it does not explain why the second certification was submitted. No changes were made to the report
Comment 19	While technically correct, the full relationship was not disclosed to HUD and was therefore misleading. No changes were made to the report.
Comment 20	The certification that Hillside Health Center was an arms-length transaction was an incorrect certification. When one person has a significant interest in both parties to a transaction and the parties act differently in this transaction than they do in transactions with unrelated parties, the transaction cannot be considered arm's length. No changes were made to the report.
Comment 21	See Comment 2.
Comment 22	Management fees were not mentioned in our report. Partners' fees and executive service fees were received by the owner, who was also the executive vice president, but these fees were not necessary operating expenses and the mortgagee should have sufficient knowledge of real estate to know this. Therefore, the use of project funds for unearned fees should have been reported to HUD. We have edited the report for clarification.
Comment 23	Current distributions from companies owned by the executive vice president would be lost by reporting his improper distributions or failure to make mortgage payments. This creates a disincentive for the executive vice president (who was the one with the knowledge) that would not be present under normal circumstances. He would have also been susceptible to administrative sanctions. No changes were made to the report.
Comment 24	The report states that the executive vice president benefits from the profits generated on \$19 million in interest. The report <u>did not</u> state that Suburban Mortgage made a profit of \$19 million. No changes were made to the report.

Comment 25	<p>General industry practice requires all estimated tax and insurance payments due up until the amortization of the escrow (end of construction) be covered by loan proceeds. This gives the mortgage company control over ensuring payments are made. Therefore, when the amortization period was postponed and the loan proceeds were no longer covering the payments, the source of those payments were no longer known or controlled by Suburban Mortgage. Mortgage companies maintain control of tax and insurance payments to protect their risk from tax liens and damage to the premises not covered by insurance. Since HUD insured the loan, the risk of loss was almost completely carried by HUD and it was the mortgagee's responsibility to protect HUD's interest. By not creating an escrow when the construction period was complete, HUD's investment was at risk. No changes were made to the report.</p>
Comment 26	See Comment 1.
Comment 27	We clarified the report to reflect that certain loans were not identity-of-interest loans and adjusted the recommendations.
Comment 28	As discussed in this report, Suburban Mortgage has misrepresented its relationships with these properties. Based on its inappropriate actions, the remaining identity-of-interest loans put HUD at an unacceptable risk.
Comment 29	The identity-of-interest relationships addressed in our report are between Suburban Mortgage and the identity-of-interest properties. These relationships were not clearly disclosed to HUD. No change to the report is needed.
Comment 30	Suburban Mortgage has sued HUD over HUD's decision to not pay the claim at Hillside Health Center. At the time of report issuance, the outcome of this litigation is unknown. We have adjusted the report to acknowledge the litigation.